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STATE FOR U/S JEFFERY; TREASURY FOR D/S KIMMIT AND U/S
MCCORMICK; NSC FOR GENERAL LUTE, ENERGY FOR DAS HEGBURG

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SUBJECT: WHAT IS THE U.S. VIEW OF THE PROPOSED IN-KIND
ELEMENTS OF IRAQI OIL TECHNICAL SERVICE AGREEMENTS WITH OIL
MAJORS

REF: BAGHDAD 647

11. (SBU) This is an action request. See paragraph 7.

12. (SBU) Minister of Oil Husseyn Shahrستاني spoke to EMIN by phone April 1. Asked about progress on the negotiation of the oilfield technical service agreements (TSAs) under negotiation with major international oil companies (IOCs), Shahrستاني said that the MoO and the companies have completed draft contracts with the only open issue that of payment-in-kind and the related process of giving notice of such in-kind liftings to the Development Fund for Iraq. The Minister said he is "not sure" what our attitude is on the payment-in-kind proposition, which is important, he says, to the IOCs. He recalled that, when in Baghdad in February, U/S Jeffery undertook to consult on the issue in Washington. What was our view, he asked?

13. (SBU) Shahrستاني admitted that within the GOI, the Ministry of Finance has reservations, partly based on its direct contacts with the DFI and the IMF. (The MoO itself has not had any contact with the DFI.) For his part, Shahrستاني said that he had no problem with complete transparency for crude liftings against TSA obligations, and would be fine with a requirement that calls for the parallel notification to the DFI by IOCs to establish an audit trail. He noted that the entire issue would likely come to the Council of Ministers for resolution soon. Minister of Finance Jabr says he would not sign off alone on payment in kind, dismissing what he termed, "barter arrangements" more appropriate for a bankrupt country. Asserting that Trade Bank of Iraq letters of credit should be satisfactory for payments to the IOCs, he added that past counter-trade agreements in Iraq had been plagued with corruption. Nevertheless, Jabr said that he would go along with a consensus on the issue endorsed by the Council of Ministers (COM).

14. (SBU) Some of the international oil companies have explained this aspect of a TSA would be important to them as it would substantially reduce credit risk, especially now that the GOI wants to enlarge the scope of the TSA to cover the purchase on behalf of the MoO of capital goods and tech services from third parties. In its presentation to the COM (reftel) the MoO projected that over two years some USD 2.5 billion would be cycled through this vehicle for oilfield development.

15. (SBU) As described reftel, Embassy believes that early conclusion of these TSAs is in the U.S. interest for several reasons. Most importantly, there are indications of diminishing production from Iraq's once prolific

southern fields that will affect short term revenue streams available to the GOI for reconstruction and building political stability at a critical juncture. Bringing the expertise of the IOCs to bear on the problem, particularly their expertise in modern enhanced recovery techniques, could help arrest production declines caused by primitive reservoir engineering and years of production. IOC procurement channels can deliver world-class equipment and services expeditiously in an environment where oil exploration and production equipment is in short supply. Second, such agreements could help build political acceptability of an IOC role in the Iraqi oil sector. And third, by demonstrating that Baghdad is moving towards engagement with the private sector, the early conclusion of TSAs would be likely to motivate the KRG to come back to

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the table to conclude a national level hydrocarbon law. It is of course a national hydrocarbon law that would lead to private foreign investment in hydrocarbon development under production sharing agreements and would transform the Iraqi oil sector.

¶6. (SBU) We therefore see the conclusion of TSAs as an important means to several high priority goals: higher near term production and breaking shibboleths and obstacles preventing conclusion of the hydrocarbons framework law. Also, not only will the IOCs benefit from managing these agreements, they will provide a considerable commercial opportunity for oil and gas equipment firms domiciled in the United States.

¶7. (SBU) ACTION REQUEST: Embassy requests a coordinated USG view on whether we would support allowing the IOCs to be paid through crude oil liftings for their work under the TSAs, and if so, what safeguards we should suggest to

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BAGHDAD 00001021 002 OF 002

secure the DFI's and international community's interests and to ensure Iraq's compliance with its obligations concerning the United Nations Compensation Commission(UNCC). (One major oil company has suggested to us that perhaps a counterparty, e.g., JP Morgan, could maintain an open account in both directions and could handle the DFI notice issues.) These safeguards are important, as they will help address the Finance Minister's arguments that payment in kind will be fertile ground for corrupt practices. Embassy also requests legal views as to the implications of an in-kind deal for Iraq's obligations under UNSC resolutions, in particular with respect to the UNCC, as well as to any UNSC oversight arrangements that might be required for an in-kind deal with IOCs.

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